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TAGS: ECON EINV EFIN ETRD BEXP KTDB PGOV SF
SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER OCTOBER 15, 2004 ISSUE

¶1. Summary. Each week, AMEmbassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:

- No change in Interest Rates;
- Tourism Earns More Foreign Exchange than Gold;
- Record South African Expansion Could Last Two Years;
- Housing Prices Continue to Increase;
- Manufacturing Capacity Utilization Increases;
- Carbon Trading to Begin;
- August Manufacturing Production Shows Growth;
- Building Confidence Survey at High Levels; and
- Improved Ranking in World Economic Forum's Competitiveness Survey. End Summary.

NO CHANGE IN INTEREST RATES

¶2. The South African Reserve Bank's (SARB) Monetary Policy Committee (MPC) kept interest rates unchanged after its October 13-14 meeting, leaving the repurchase rate at 7.5 percent. SARB Governor Tito Mboweni stated that targeted inflation (consumer prices excluding mortgages) should remain well within its boundaries over the next two years, increasing slightly in the near term, but moderating later. He cited a number of factors responsible for an optimistic inflationary outlook: (1) a decline in inflationary expectations; (2) fiscal prudence by government; (3) improved outlook for food prices; (4) commitment to contain administered price increases; and (5) lower average global inflation. Source: I-Net Bridge, October 14.

¶3. Comment. Earlier in the week, Mboweni had cited rising oil prices, concerns about low savings rates, rising household debt, and increased consumption rather than investment fueling growth as potential problems facing the South African economy. Out of 24 economists polled by Reuters on October 13, 22 said they expected interest rates to remain unchanged because of surging oil prices. End comment.

TOURISM EARNS MORE FOREIGN EXCHANGE THAN GOLD

¶4. Research from Standard Bank indicates that tourism is growing in importance to the South African economy, earning more in foreign exchange in 2003 (R53.9 billion, $8.3 billion, using 6.5 rands per dollar) than net gold exports (R35.3 billion, $5.4 billion). Standard Bank's research suggests that tourists are more influenced by economic growth in their own countries than the rand's level, which implies that the sector is resilient to the rand's strength, especially when compared to the mining sector. The report estimated that for every 1 percent increase in a country's GDP, the number of tourists from that country who visit South Africa would increase by 1.73 percent. On the other hand, a 1 percent increase in local currency prices would decrease tourist arrivals by only 0.04 percent. The relatively small impact on prices can be partly explained by the composition of tourists visiting South Africa. In 2003, more than half of South Africa's tourists came from other African countries, and those tourists from countries whose currency is pegged to the rand (Swaziland, Lesotho, Namibia and Botswana) comprised 20 percent of total foreign tourist spending. For these tourists, their demand would be less sensitive to overall price changes, since the prices they pay are not influenced by the rand exchange rate and their local markets are limited and expensive. Standard Bank estimates that tourist arrivals could increase 3 percent next year, more than double last year's growth rate of 1.2 percent. Even if the rand remains at current levels, tourist arrivals should grow by more than 2 percent. Source: Business Day, October 12; Standard Bank Insight, October 11.

RECORD SOUTH AFRICAN EXPANSION COULD LAST TWO YEARS
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¶5. The Credit Guarantee Insurance's (CGI) latest economic and business review suggests that the current five-year South African expansion could last two more years. Lower structural inflation meant lower interest rates could last into 2005 and beyond, but this depends on oil prices and domestic secondary-round price increases being muted. Despite a 'strong' exchange rate, the manufacturing sector is expanding rapidly and business confidence indicators are at an all-time high. Luke Doig, senior economist at CGI warned that protectionist policy, a substantially weaker rand, and over-regulation all serve to raise costs and divert attention away from satisfying the real needs of consumers. CGI is forecasting a 2.8 percent GDP growth rate this year from 1.9 percent last year and expects growth to accelerate to 3.7 percent in 2005. Source: I-Net Bridge October 12.

¶6. Comment. The highest GDP growth rate in post-apartheid South Africa (since the April 27 1994 elections) was 7.7 percent in the second quarter of 1996. The average GDP growth over the past 10 ten years is 2.8 percent. Now South Africa has recorded 23 consecutive quarters of economic growth, with the previous record for consecutive positive quarterly GDP growth at 44 quarters occurring in the early 1960s. End comment.

HOUSING PRICES CONTINUE TO INCREASE

¶7. The ABSA Bank house price index in August continues to show record growth, increasing a nominal 33.7 percent, y/y, its highest in 23 years. Helped by strong growth in household incomes and low nominal interest rates, property prices reflect increased demand. As a result of the sharp increase in residential property prices during 2003 and the first nine months of this year, ABSA decided to lift the upper cut-off price for residential properties in the middle market from R1.8 million ($280,000) last year to R2.2 million ($340,000) this year. The upper cutoff price in the luxury market was increased from R6.5 million ($1 million) in 2003 to R8 million ($1.2 million) this year. ABSA's real (adjusted for inflation) housing price index indicated that there was 32.7 percent year-on-year growth in August compared to July's 30.9 percent increase. Source: Business Day, October 12.

CAPACITY UTILIZATION INCREASES

¶8. The capacity utilization for large manufacturers increased to 84.2 percent in May 2004 up from 83.3 percent in February according to Stats SA. The rise of 1.1 percent or 0.9 percentage points was mainly due to higher demand. The largest rise was reported in food and beverages (up 2.4 percentage points) followed by motor vehicles and parts (up by 2 percentage points). Source: Business Day, October 12.

CARBON TRADING TO BEGIN IN SA

¶9. Subject to approval from South Africa's JSE Securities Exchange, Sterling Waterford Securities will list carbon-trading credits by the end of 2004. The carbon credits allow companies in developed countries trying to meet stringent carbon controls to buy credits from companies in countries that pollute less than their allotted limits. The draft National Energy Bill, legislation already approved by the cabinet, will establish a designated national authority to handle carbon credits with regard to the Kyoto protocol. Currently, the price of carbon credits is between $3 and $7 a ton. Currently, South Africa has the third-highest per capita rate of emissions of greenhouse gases in the world. Russia is expected to provide most of the carbon credits to the market. Source: Business Day, October 11.

MANUFACTURING PRODUCTION SHOWS ROBUST AUGUST GROWTH
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¶10. Manufacturing production increased 6.8 percent (y/y) in August, its strongest growth in nearly two years, compared to July's growth of 5.2 percent. From April 2003 until February 2004, manufacturing production slipped into recession, with March being the first month of positive growth. On a quarterly basis, 8 of the 10 manufacturing industries showed stronger growth, with the fastest growth occurring in the glass, food and beverages, motor vehicles, petroleum and chemical products. However, there are signs of weakening growth. When measured monthly on a seasonally adjusted basis, manufacturing production growth and manufacturing sales declined 0.8 percent and 0.3

percent respectively between July and August. The August quarterly growth in manufacturing production reached 2 percent, down from July's quarterly growth of 2.5 percent. Source: Business Day, October 13; Standard Bank Manufacturing Unpacked, October 12, September 7; Statistics South Africa Statistical Release P 3041.2.

¶11. Comment. The manufacturing sector, accounting for 18 percent of gross domestic product, weakened in 2003 due to stagnant global growth and the strong rand. However, strong domestic demand caused by low interest rates and improving export outlook has boosted manufacturing growth prospects for 2004. End comment.

BUILDING CONFIDENCE SURVEY HIGH

¶12. The Bureau for Economic Research's confidence index for residential building contractors show most building contractors expect activity to improve this quarter. However, 89 percent of those surveyed complained about a shortage of skilled labor. Confidence of residential contractors scored 87, close to the record high of 90 reached in the second quarter 2004 and confidence among nonresidential contractors rose to 74, also close to the second quarter's level of 72. Skill shortages could lead to an increase in wages for the sector, especially given strong growth in both housing and retail construction. Source: Business Day, October 13.

IMPROVED RANKING IN WORLD ECONOMIC FORUM'S COMPETITIVENESS INDEX
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¶13. The latest annual World Economic Forum's (WEF) competitiveness survey ranks South Africa 42 out of 104, an improvement of just one place over last year. Now, however, South Africa is the most competitive economy in the continent, ahead of Botswana, which dropped nine places. Ranked highest in Africa, South Africa's ranking is still below many of its competitors, such as Chile, Poland and Estonia. Ranking 22, Chile was the only South American country to rank above South Africa, with Mexico only 48. The survey comprised 8,700 business leaders and emphasized macroeconomic environment, the quality of public institutions and technological innovation. The four components of WEF's Global Competitiveness Index (GCI) show a varied picture for South Africa, with the country ranked 40th on technology, 48th on macroeconomic environment and 35th on public institutions. South Africa's best performance is in business competitiveness, where it ranked 25th, based on the strength and regulation of its financial markets, corporate governance and "general effectiveness" of government policies. According to WEF, South Africa's competitive disadvantages include labor market issues, such as ease of hiring foreign labor, hiring and firing practices and flexibility of wages. HIV/Aids and crime are also cited as negatives. Source: This Day and Business Report, I-Net Bridge October 14.